

Chapter 27: Exam practice question

Dell to continue price cuts as PC sales slow down

- 1 Define the terms:
- a **(HL)** destroyer or predatory pricing (2)
- This refers to a strategy of deliberately undercutting a competitor's prices in order to put them out of business, after which prices are raised. This is illegal in the EU but it is very difficult to prove as it can be claimed that a competitive pricing strategy was being used.
- b sales revenue. (2)
- This is the income generated from selling products or services. It is sometimes referred to as turnover or sales turnover.

Apply **Resources table 3a** mark band descriptors.

- 2 Explain the impact a reduction in the price of computers might have on the demand for computer software. (6)
- The demand for computers would probably rise. This in turn would probably increase the demand for related computer software.
- This may be complicated if the related software prices are increased. This latter change could then result in a conflicting cross-price effect on demand for computers.
- There may also be related changes if advertising of the computers or the software is increased or decreased at the same time that computer prices are reduced.
- It is possible, however, that if computer prices were not very price elastic, lowering the price could have little effect on computer sales and so the knock-on effect on software sales could be similarly small. As Question 3 states that the demand for Dell computers is thought to be price elastic, this would not apply to them.

This is a more difficult question than it first appears. Students need to recognise the full complexities of the cross-elasticity of demand situation in order to be awarded the full 6 marks.

SL: apply **Resources table 1** mark band descriptors.

HL: apply **Resources table 2** mark band descriptors.

A justified conclusion is **not** required.

- 3 **HL only:** The demand for Dell computers is thought to be price elastic.
- a Explain what this statement means. (2)
- Price elasticity =
$$\frac{\text{percentage change in quantity demanded}}{\text{percentage change in price}}$$

Price elastic means that the above calculation produces an answer greater than 1. This means that for every 1% by which the price is increased, the quantity demanded changes by more than 1%.

Apply **Resources table 3a** mark band descriptors.

b Analyse **one** reason why the demand for Dell computers might be price elastic. **(6)**

Reasons could include:

- USP
- brand image
- advertising
- fashion trends in consumer tastes
- economic recession can make consumers more price determined in their purchasing habits
- any other relevant point.

SL: apply **Resources table 1** mark band descriptors.

HL: apply **Resources table 2** mark band descriptors.

Reasons should be stated, explained and linked to the case study.

Analysis also requires students to examine positive and negative aspects of each reason.

A justified conclusion is **not** required.

c Discuss the advantages and disadvantages to Dell of reducing the price of its computers to increase market share. **(9)**

Define market share:

$$\text{Market share} = \frac{(\text{value of items sold by this firm in a market and time period})}{(\text{value of similar items sold by other firms in same market and time period})} \times 100\%$$

Advantages of reducing prices to increase market share:

- The effect on sales may be fast.
- Competitors may be unable to meet or undercut the price if their cost is high or their cost structure is inflexible.
- The effect on sales may be bigger than the change in price if elasticity is high.
- It could cost less than a major advertising campaign.
- Any other relevant point.

Disadvantages of reducing prices to increase market share:

- Profits may fall if costs cannot also be reduced or if elasticity is not sufficiently high to absorb the price fall.
- It may start a price war in which no manufacturer eventually benefits.



- The company may be accused of illegal predatory pricing.
- Low prices may be interpreted by consumers as low quality and so they may not buy the product.
- Any other relevant point.

SL: apply **Resources table 1** mark band descriptors.

(SL questions do not usually go up to 9 marks, so the HL table is best used for SL students.)

HL: apply **Resources table 2** mark band descriptors.

A justified conclusion is required.